United States Court of Appeals

for the Second Circuit

APPELLEE'S BRIEF

ORIGINAL

74-2142

United States Court of Appeals

For the Second Circuit.

In the Matter of
JERCYN DRESS SHOP, a Partnership.

LESLIE SAY SALES, a Division of LESLIE SAY INC., FALCHICK DRESS CO., INC., CAMPUS JUNIORS, INC.,
Appellants,

JACK A. SCHERER and EVA SCHERER, as general partners, jointly,
Appellees.

On Appeal from the United States District Court
For The Eastern District of New York

APPELLEE'S BRIEF

HAUPTMAN & HAUPTMAN
Attorneys for Appellee, Jack A. Scherer
32 Court Street
Brooklyn, New York
(212) 875-8997

NATHAN B. FOGELSON
Attorney for Appellee, Eva Scherer
7 Dey Street
New York, New York
(212) 267-3030

Dick Bailey Printers • P.O. Box X, Staten Island, N.Y. 10302 • Tel.: (212) 447-5358

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In the Matter

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74-2142

JERCYN DRESS SHOP, a partnership, and JACK A. SCHERER and EVA SCHERER, as general partners, jointly,

Alleged Bankrupts.

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On Appeal from the United States District Court for the Eastern District of New York

PRELIMINARY STATEMENT

The Orders Under Review

This joint brief is being submitted by the two appellees, JACK A. SCHERER and EVA SCHERER, alleged bankrupts, the two individuals who were the co-partners of the above-named partnership bankrupt, JERCYN DRESS SHOP, in support of the order of the District Court (Neaher, J.), (80-92) affirming an order of the Bankruptcy Court (Price, J.), (64-75) which granted the appellees' motion to dismiss the involuntary petition in bankruptcy insofar as it was addressed to them, on the ground that they, as individuals, did not commit any act of bankruptcy within the contemplation of Sec. 3(a)(4) of the Bankruptcy Act.

STATEMENT OF ISSUE PRESENTED

1. When the individual partners of a partnership execute a partnership general assignment for the benefit of partnership creditors of partnership assets only, has each of the assigning partners thereby also committed an individual act of bankruptcy?

THE FACTUAL BACKGROUND

The facts are not in dispute.

JERCYN DRESS SHOP is a co-partnership comprised of two partners, JACK A. SCHERER and EVA SCHERER, his wife, (now separated), the individual Alleged Bankrupts (34-35,651).

By a written indenture dated and executed October 19, 1972, and filed in the New York State Kings County Clerk's Office on October 20, 1972, JERCYN DRESS SHOP, therein described as "a co-partnership comprised of Jack A. Scherer and Eva Scherer", assigned its partnership assets for the benefit of its creditors to BERNARD SANDS, of 505 Eighth Avenue, New York, N.Y.; the latter duly qualified as Assignee, who, with judicial approval granted by the Supreme Court, Kings County, duly sold all the partnership assets. (12-24; 65-67).

By an involuntary petition dated November 15, 1972, three partnership creditors filed their petition in this Court asking adjudication of both the partnership and the individual partners. (3-7)

The only act of bankruptcy alleged in the petition against both the partnership and the individuals comprising the partnership is that which is set forth in Par.4 of the involuntary petition, which reads as follows:

> "4. Within four months next preceding the filing of this petition, the alleged bankrupts committed an act of bankruptcy in that the alleged bankrupts did heretofore, to wit, on or about October 20, 1972, make an assignment for the benefit of creditors to Bernard Sands, which assignment was recorded in the Office of the Clerk of County of Kings, State of New York, on October 20, 1972." (6)

JERCYN DRESS SHOP, the co-partnership, consented to its adjudication in bankruptcy by a consent dated and filed December 6, 1972. (66)

However, the individual partners, the Alleged Bankrupts, namely, JACK A. SCHERER and EVA SCHERER, filed a joint answer denying the material allegations of the involuntary petition, and alleging two affirmative defenses. (14-17)

The first defense alleged that only the co-partnership, JERCYN DRESS SHOP, made the assignment for the benefit of creditors; the assignment was the act of only JERCYN DRESS SHOP, the co-partnership, and was not an assignment made by the individual Alleged Bankrupts, namely, JACK A. SCHERER and EVA SCHERER (18-25); hence, no act of bankruptcy as defined in Sec. 3(a) of the Act, was set forth in the involuntary petition as against the individual Alleged Bankrupts. (28-41)

The second defense pleaded that the assignee for the benefit of creditors was selected by the partnership's creditor body to act for the partnership's creditors, and to accept the assignment on behalf of the partnership's creditor body; that said partnership assignee accepted such assignment, has acted, and is now acting thereunder on behalf of the partnership's creditors; that by virtue thereof, the moving creditors (and creditors generally), are estopped from utilizing said partnership assignment for the benefit of creditors, in which they acquiesced, as a basis for their filing an involuntary petition against the individual partners. (16)

After service of their answer, the individual Alleged Bankrupts moved before the Bankruptcy Judge for an order dismissing the involuntary petition, to the extent that it is addressed to JACK A. SCHERER and EVA SCHERER, individually and as general partners in the co-partnership of JERCYN DRESS SHOP, for the following reasons:

A. The involuntary petition alleges, as the only act of bankruptcy, that the individual Alleged Bankrupts executed the assignment for the benefit of the creditors in the name and in behalf of JERCYN DRESS SHOP, the co-partnership, which is the only entity which executed and filed the assignment.

B. No act of bankruptcy, as contemplated by

Sec. 3(a)(4) of the Act, is alleged in said petition to have been committed by the individual Alleged Bankrupts in their individual capacity - as distinguished from their partnership capacity.

C. The assignment executed by the partnership was executed by JERCYN DRESS SHOP, a co-partnership, comprised of JACK A. SCHERER and EVA SCHERER; its purpose, scope, intent, and legal effect was to assign the assets of the partnership only, and not the assets of the individual partners; hence, no act of bankruptcy, as contemplated by Sec.3(a)(4) of the Act, has been alleged in the petition to have been committed by the individual Alleged Bankrupts so as to constitute an act of bankruptcy on their individual parts. (28-40)

JUDGE PRICE'S RULING

In light of the foregoing undisputed facts, Judge Price granted the motion of the Alleged Bankrupts to dismiss the involuntary petition and sustained the rationale advanced by the Alleged Bankrupts in support of their motion to dismiss, namely, that the partnership assignment for the benefit of creditors, relied on by the petitioning creditors as the act of bankruptcy allegedly committed by the individual partners, was, in fact and in law, the act of the partnership only; hence, the partnership assignment for the benefit of creditors did not constitute an individual act

of bankruptcy, as against the individual partners, within the contemplation of Sec. 3(a)(4) of the Bankruptcy Act. (64-79)

JUDGE NEAHER'S RULING

Thereupon, the petitioning creditors, feeling aggrieved, filed their petition to review Judge Price's order of dismissal. (80-84)

Judge Neaher, in sustaining the order of dismissal, stated, inter alia:-

> "This petition to review an order of the bankruptcy judge presents but a single question of law: When partners of a partnership make and sign a general assignment for the benefit of creditors of the partnership assets only, such that the partnership is found to have committed an act of bankruptcy, has each of the assigning partners thereby also committed an individual act of bankruptcy? The court's conclusion, for the reasons set forth below, is that such an assignment is not automatically or necessarily an individual act of bankruptcy by the co-assignors (84-92)."

It is from this order of Judge Neaher that the Appellants now appeal.

THE ARGUMENT

POINT I

A. The execution by a partnership, acting through its individual partners, of a partnership assignment of partnership assets for the benefit of partnership creditors, does not, ipso facto, constitute an act of bankruptcy purportedly committed by the individual partners within the contemplation of Sec.3(a)(4) of the Bankruptcy Act.

B. The creditors' involuntary petition, addressed both to the partnership entity and to the individual partners comprising the partnership, and based exclusively on the single allegation that the partnership, acting through its individual partners, executed the partnership assignment of the partnership assets for the benefit of the partnership creditors, to the extent that such petition for adjudication is addressed to the individual partners, fails to set forth sufficient facts to constitute an individual act of bankruptcy against the individual partners.

Sec. 3 of the Bankruptcy Act entitled, "Acts of Bankruptcy", provides:

> "(a) Acts of bankruptcy by a person shall consist of his having *** (4) made a general assignment for the benefit of his creditors."

The only act of bankruptcy alleged against the individual partners is found in Par. 4 of the involuntary petition and reads:

> "4. Within four months next preceding the filing of this petition, the alleged bankrupts committed an act of bankruptcy in that the alleged bankrupts did heretofore, to wit, on or about October 20, 1972, make an assignment for the benefit of creditors to Bernard Sands, which assignment was recorded in the office of the Clerk of the County of Kings, State of New York, on October 20, 1972." (6)

As the assignment indenture annexed to the answer of the Alleged Bankrupts indicates, without any dispute, that instrument was executed by "Jercyn Dress Shop, a Co-partnership comprised of Jack A. Scherer and Eva Scherer". (18)

The involuntary petition does not allege an

assignment for the benefit of the creditors by the Alleged Bankrupts, as individuals, of any of their individual assets.

Sec. 5 of the Bankruptcy Act, dealing with the bankruptcy of partnerships and the partners comprising the partnerships, contemplates a general structure whereby a partnership may be separately petitioned into bankruptcy; in the event of a partnership insolvency, to the extent that partnership assets are insufficient to pay partnership debts in full, the personal assets of the individual partners are made subject to the demands of the creditors.

Hence, it is entirely cognizable under the Bankruptcy Act, that a partnership, qua partnership, may be adjudicated a bankrupt, without the individual partners being adjudicated.

Here, it is noteworthy, that in the course of the evolution of the concept of partnership bankruptcy and individual partner bankruptcy, there was doubt whether a partnership was a "person", within the definition of Sec. 3 of the Act, so as to be subject to its being petitioned into bankruptcy.

That doubt, whether a partnership was a "person" subject to being petitioned into bankruptcy, was resolved by the Congressional enactment of the 1898 Bankruptcy Act, which, for the first time, declared that a partnership was a "person" subject to being petitioned into bankruptcy, and

set up a legal mechanism for the separate adjudication of the partnership, on the one side, and of the individual partners, on the other, provided, that in each instance, adequate allegations of the commission of an act of bankruptcy, be alleged in the involuntary petition.

The case of Chemical National Bank vs. Meyer, 92 Fed. 896, affirmed 98 Fed. 976, relied upon by appellants, was based upon pre-1898 bankruptcy law, that is, before Congress declared that a partnership was a "person" subject to being petitioned into bankruptcy, so that under pre-1898 bankruptcy law, the individual partners were subject to being petitioned into bankruptcy because they, as partners, executed the partnership assignment.

However, the Chemical Bank holding was altered by the Supreme Court holding in Liberty National Bank vs. Bear, 276 U.S. 215 (1928), discussed infra.

The fourth act of bankruptcy set forth in Sec. 3 of the Act, that a debtor "made a general assignment for the benefit of its creditors", is posited on the concept that the debtor, by making such general assignment of his assets, has placed his assets beyond the reach of creditors, that is, by placing them in the hands of an assignee for the benefit of creditors.

In the case at bar, the partnership assignment indenture clearly establishes that it was a partnership act,

and that the intent and scope of the indenture was to assign only partnership assets to the assignee for the benefit of creditors; so that creditors continue free to pursue the individual Alleged Bankrupts, as individual partners, for the payment of partnership debts, regardless of the fact that the partnership has consented to its adjudication in bankruptcy.

The legal doctrine on which Judge Price and Judge Neaher based their rulings, namely, that the bankruptcy of the partnership does not mean, ipso facto, the bankruptcy of the individuals comprising the partnership, was discussed in the Supreme Court of the United States in Liberty National Bank vs. Bear, supra.

There, it appeared that in July, 1920, the Liberty National Bank (Bank) brought suit in the State Courts against a partnership and its individual partners. Judgment was duly docketed on the default of the defendants, so that the judgment thereupon became a lien on real property then owned by the individual partners.

In August, 1920, an involuntary petition was filed against the partnership, alleging that it had committed an act of bankruptcy by executing, (as in the case at bar), a general assignment of its assets for the benefit of its creditors, and was insolvent. Noteworthy is the fact that there was no allegation in the petition that the partners (Becker) were insolvent, or had executed general

assignments of their individual properties, or had committed an act of bankruptcy.

The partners thereupon filed a joint answer admitting the allegations of the petition, and the company, as a partnership, composed of its two partners, was adjudged a bankrupt, but without adjudging the bankruptcy of the individual partners.

In April, 1921 - more than eight months after the partnership had been adjudicated a bankrupt - the partners filed their separate, individual voluntary petitions in bankruptcy, and were adjudicated.

Thereupon, the judgment creditor-bank, which, as stated above, had docketed its judgment against both the partnership and the individual partners in July, 1920, filed a proof of claim with the Trustee in Bankruptcy against the separate estates of the individual partners, contending that the judgment constituted a valid lien upon their individually owned real estate.

The Trustee countered by filing objections to the Bank's claim that it had a valid lien against the real property owned by the individual partners as of the date of the filing of the petition in bankruptcy against the partnership in August, 1920.

The basis for the Trustee's contention was that since the Bank's judgment had been recovered within four months prior to the filing of the involuntary petition

against the partnership, the lien upon the individual properties of the partners was voidable under the provisions of Sec. 67(f) of the Bankruptcy Act.

The Referee sustained the Trustee's contention, and disallowed the Bank's claim of a judicial lien against the real property owned by the individual partners.

However, on review, the Referee's order was reversed by the District Judge on the ground that since the order adjudicating the partnership in bankruptcy had not adjudicated the bankruptcy of the individual partners, the lien of the Bank's judgment upon their individual property was not voidable under Sec. 67 of the Act, since the judgment was filed more than four months before the individual partners were adjudicated bankrupts.

On appeal, the Court of Appeals, (agreeing with the Referee), reversed the District Judge upon the ground that the adjudication of the partnership was necessarily an adjudication of the bankruptcy of the individuals comprising it, and that the lien of the judgment obtained against the individuals within four months before filing of the petition against the partnership was lost by the partnership adjudication.

However, on appeal to the Supreme Court, the order of the Court of Appeals, (and of the Referee) was reversed, and the Bank's lien against the real property owned by the individual partners was sustained; the matter

was then remanded to the District Court for further proof.

The indefatigable Trustee thereupon amended his objections to the Bank's claim to the lien against the real property owned by the individual partners by alleging that the individual partners were insolvent when the Bank's judgment was recovered, and that if the Bank's lien were recognized, the judgment would result in a preference to the Bank.

The parties to the dispute then stipulated before the Referee that the individual partners were, in fact, insolvent when the Bank's judgment was obtained against the partners, and that the enforcement of that judgment against the individual properties of the partners would enable the Bank to obtain a greater percentage of its debt from such assets other than non-lien creditors.

The Referee thereupon again disallowed the claims of the Bank against the individual estates of the partners as preferences under Sec. 67. These findings by the Referee were affirmed by the District Court, and on appeal were affirmed by the Circuit Court of Appeals.

However, on appeal to the Supreme Court, the orders of all the lower courts disallowing the lien were reversed, and the liens recognized.

In relevant part, the opinion of the Supreme Court, on this second reversal, states:

"The Trustee relies upon both 67(c) and 67(f) of the Act. Sec. 67(c) provides: A lien created by suit begun within four months before the filing of a petition in bankruptcy against such a person shall be dissolved by the adjudication of such person to be a bankrupt if *** it appears that said lien was obtained *** while the defendant was insolvent and that its existence and enforcement would work a preference. Sec. 67(f) provides: All levies, judgments *** obtained through legal proceedings against a person who is insolvent, at any time within four months prior to the filing of a petition in bankruptcy ***.

It is indisputable that under these provisions, the judgment lien upon the real estate of the Beckers cannot be annulled unless they were adjudicated bankrupts under petitions in bankruptcy filed within four months after the suit against them was commenced ***. This being unquestioned, the Trustee does not claim that the liens were annulled under the voluntary petitions of the Beckers which were filed after the expiration of the prescribed periods. His sole contention is that they were annulled by the proceeding under the involuntary petition filed against the partnership within such periods. As to this, he insists that - although the petition was filed against the partnership alone, and the partnership alone was adjudicated a bankrupt - the petition was, in effect a petition against the individual partners, as well as the partnership, and the adjudication was, in effect, an adjudication that the individual partners, as well as the partnership, were bankrupts; that is, that the adjudication that the partnership was a bankrupt necessarily imported an adjudication that the individual partners were also bankrupts.

This contention disregards entirely the principle established by the Bankruptcy Act that a partnership may be adjudicated a bankrupt as a separate entity without a reference to the bankruptcy of the partners as individuals.

It has long been the established rule in the Circuit Court of Appeals and District Courts that under Sec. 5(a) of the Act, a partnership may be adjudicated a bankrupt as a separate entity under voluntary or involuntary petition, irrespective of any adjudication of bankruptcy against the individual partner. In re: Meyer, Circuit Court of Appeals, 98 Fed. 976, 979, (cases cited). This rule has been

applied not only where the petition in bankruptcy sought merely the adjudication of the partnership as a bankrupt, but where the adjudication of the individual partners was also sought. Thus, in some cases, the partnership was adjudicated a bankrupt, although the court refused to adjudicate the bankruptcy of the individual partners, either because they had not committed individual acts of bankruptcy ***.

We cannot believe that Congress intended to limit and weaken the broad provisions of Sec. 5(a) permitting a partnership to be adjudicated a bankrupt, by making it essential to such an adjudication that the partners should also be adjudicated bankrupts, individually. So to hold would make it impossible, in an involuntary proceeding, to adjudicate bankrupt a partnership as a separate entity, although it was insolvent, and had committed an act of bankruptcy, if any of the partners could not be adjudicated a bankrupt because he had not committed an individual act of bankruptcy."

The principles pronounced in the Liberty National Bank case, supra, briefly stated, are:

A. A co-partnership, and the individuals comprising the partnership, are, within the contemplation of Secs. 3 and 5 of the Bankruptcy Act, separate entities;

B. An act of bankruptcy committed by the one entity, namely, the partnership, is not imputed, ipso facto, to the other entity, namely, to the individual partners comprising the partnership; and

C. In order to adjudicate in bankruptcy both the partnership and the individuals, each entity must have committed its own act of bankruptcy.

Applying the foregoing principles enunciated in the Liberty National case to the undisputed facts in the

case at bar, it is submitted that the act of the partnership, in having executed an assignment of its assets for the benefit of its creditors, does not, ipso facto, constitute an act of bankruptcy on the part of the individual partners.

Hence, since it is not disputed that the only assignment for the benefit of creditors relevant to this proceeding was the one executed by the partnership, it must follow that only the partnership, and not the individual partners, committed the act of bankruptcy; and since the only act of bankruptcy alleged in the involuntary petition is the one committed by the partnership, the involuntary petition, as it is addressed to the individual partners, is fatally defective, and was properly dismissed.

Bankruptcy Judge, Manuel J. Price, adopted the reasoning of the Supreme Court in Liberty National Bank vs. Bear, supra.

Judge Price, in his opinion, stated as follows:

> "In the case at bar, the assignment for the benefit of creditors relied on by the petitioning creditors as an act of bankruptcy was executed by the partnership, Jercyn Dress Shop, as an entity and not by the Scherers as individuals. This partnership act could not be imputed ipso facto to them and thus be used as an act of bankruptcy against them. To accept the contention of the petitioning creditors would mean that the partnership entity could never be separated from the individual partners in bankruptcy proceedings since the partnership could only commit an act of bankruptcy through one of its partners. This flies in the face of the clear language of Section 5 a and b of the Bankruptcy Act, II U.S.C. Sections 23 a and b, which specifically provide for the adjudication of the partnership alone, independent of the adjudication of any partner. Of

course, this does not mean that the partnership creditors are stayed or restrained from proceeding to collect their debts from the individual partners since Section 5 J of the Bankruptcy Act, II U.S.C. 23 J, provides that 'the discharge of a partnership shall not discharge the individual general partners thereof from the partnership debts.'

The motion of Jack A. and Eva Scherer to dismiss the involuntary petition in bankruptcy filed against them is granted."

District Judge Neaher, in affirming Judge Price's opinion, and in commenting on the impact of Liberty National Bank vs. Bear, supra, stated:

> Subsequently, the Supreme Court in Liberty made it clear that §5(a) of the Bankruptcy Act permitted a partnership to be adjudged a bankrupt alone, it not being 'essential to such an adjudication that the partners should also be adjudged bankrupt individually, 276 U.S. at 224-225 ***'.
>
> Liberty also makes clear that the acts of partners may be judged on an individual basis, apart from an involuntary petition which seeks not an adjudication against them as individuals, but only one against the partnership, and that a partner does not necessarily commit an individual act of bankruptcy when the partnership does. 276 U.S. at 223; (emphasis supplied)
>
> Thus, even though the Court in Liberty did not rule on the exact question presented here, we agree with one noted authority that 'there can be no serious question but that, to throw an individual partner into bankruptcy, as contrasted with accomplishing this result as to the firm, a partnership act of bankruptcy will not suffice; the act must be his individual act as well, or he must have committed some other individual act of bankruptcy. (Emphasis supplied); Remington on Bankruptcy, §86 at 154 (1950)."

Both lower court judges noted, in their respective opinions, that the partnership assignment for the

benefit of creditors, on which the involuntary petition is based, was made by the partnership as an entity, and not by the Scherers as individuals; and that only partnership property was affected by that partnership assignment. Thus, Judge Neaher states:

> "There is no suggestion of a general assignment by an individual partner of his own assets, an individual act of bankruptcy for which joint adjudication with the present partnership act of bankruptcy would be contemplated (90)."

POINT II

COMMENTS ON POINT I IN APPELLANTS' BRIEF

A.

Appellants devote a substantial portion of their brief to an analysis of the hypothetical impact of the New York Partnership Law on the facts in this proceeding, and on the sequelae of the holdings of Judge Price and Judge Neaher dismissing the involuntary petition as against the individual partners.

Appellants contend that, as a result of these rulings, creditors may be hindered in enforcing their claims against the individual partners, and against whatever individual assets the individual partners may own.

Appellees submit that nothing in the New York Partnership Law prevents partnership creditors from suing the individual partners to collect on unpaid partnership debts.

In fact, various partnership creditors have already sued the individual partners. (54-55)

It should be noted here that Sec. 5(a) of the Bankruptcy Act specifically provides that:

> "A partnership *** may be adjudged a bankrupt either separately or jointly with one or more of its general creditors."

So that, parallel with a partnership bankruptcy, creditors may enforce their partnership claims against the individual partners in state court actions, without being delayed in the enforcement of their rights against the individual partners by virtue of the pendency of the partnership bankruptcy proceeding.

B.

Appellants do not fully concede the teaching of Liberty National Bank vs. Bear, supra, (1928).

Liberty stands for the holding that an act of bankruptcy committed by a partnership, such as an assignment of partnership assets for the benefit of partnership creditors, does not ipso facto constitute an act of bankruptcy by the individual partners who comprise the partnership.

Liberty holds that individual partners may not be adjudicated bankrupts merely because they, qua partners, executed the partnership assignment for the benefit of creditors, and that before such individuals may be adjudi-

cated, there must be an adequate allegation that they, individually, committed an act of bankruptcy other than their having executed, in their capacity of partners, the partnership assignment for the benefit of creditors.

CONCLUSION

THE ORDERS OF THE DISTRICT COURT AND OF THE BANKRUPTCY COURT, DISMISSING THE INVOLUNTARY PETITION AS AGAINST THE INDIVIDUAL PARTNERS, SHOULD BE AFFIRMED.

Dated: December 11, 1974.

Respectfully submitted,

HAUPTMAN & HAUPTMAN
Attorneys for Appellee,
Jack A. Scherer
32 Court Street
Brooklyn, N. Y.

S. A. HAUPTMAN,
of counsel.

NATHAN B. FOGELSON
Attorney for Appellee,
Eva Scherer
7 Dey Street
New York, N. Y.

zdq HAUPTMAN

STATE OF NEW YORK)
: SS:
COUNTY OF RICHMOND)

ROBERT BAILEY, being duly sworn, deposes and says, that deponent is not a party to the action, is over 18 years of age and resides at 286 Richmond Avenue, Staten Island, N.Y. 10302. That on the 5 day of December , 1974 deponent served the within appellee's brief upon ROBERT P. HENZOG,

attorney(s) for appellant

in this action, at 135 Madison Ave. NYC 10016

the address designated by said attorney(s) for that purpose by depositing 3 true copies of same enclosed in a postpaid properly addressed wrapper, in an official depository under the exclusive care and custody of the United States post office department within the State of New York.

Robert Bailey
ROBERT BAILEY

Sworn to before me, this
5 day of December, 1974

William Bailey
WILLIAM BAILEY
Notary Public, State of New York
No. 43-0132945
Qualified in Richmond County
Commission Expires March 30, 1976